



# CITY OF HOUSTON

Finance Department

## Interoffice

Correspondence

To: Budget and Fiscal Affairs Committee

From: Michelle Mitchell, Director  
Finance Department

Date: April 29, 2008

Subject: Credit Market Review and Update

This will provide an update to the memo presented on February 29, 2008 (see attached) as it relates to the turmoil in the Credit Markets and the progress being made in addressing these issues, specifically as it relates to Auction Rate Securities ("ARS").

As outlined in the memo of February 29, 2008, the City utilizes a variety of debt structures. The more problematic of these structures involves the ARS structure. At the time of the February 28<sup>th</sup> memo, the City had outstanding a total of \$1.872 billion in ARS Securities that were distributed among the City's Enterprise Funds in the following amounts:

- Combined Utility System ("CUS") - \$1.377 billion
- Houston Airport System ("HAS") - \$345 million
- Convention and Entertainment ("C&E") - \$150 million

Also described in the February memo, ARS Securities have an embedded "failed rate" in the event there are insufficient bidders for the available bonds, which is termed a "failed auction." Most, if not all of the auctions had become failed auctions in early February, and have been resetting at the failed rate. That failed rate is based on a formula unique to each issue. It is typically a multiple of some index, typically LIBOR. The more punitive failed rates were those tied to the ARS issued by the CUS. This fact as well as the total amount of bonds outstanding necessitated that the CUS ARS bonds be given the higher priority.

### Combined Utility System

Starting the week of April 11, 2008, the City successfully converted \$653 million of the CUS Series 2004B Bonds out of the ARS structure and converted those bonds into Variable Rate Demand Bonds ("VRDB"). Upon conversion into the VRDB structure, the rates paid by the CUS at the initial weekly auction for the VRDB's went from a failed rate of near 7% in the ARS mode to a rate of approximately 2% once converted, a savings of approximate \$2.5 million per month. In addition, the market demand for these securities was strong as illustrated by the oversubscription. For more detailed information on this transaction, see the attached post deal review provided by Estrada Hinojosa, the City's co-financial advisor.

As outlined in the February memo, some segments of the CUS bonds required different solutions depending on various unique underlying issues. Monoline insurers, overlapping Swaps, Letter of Credit requirements, availability and cost as well as tax status are a few of the issues to resolve. The remaining \$724 million in ARS are scheduled to be converted or refunded over the next 4 to 8 weeks in the following manner:

- CUS Series 2004C1, 2A, 2B and a portion of 2E (\$275 million):
  1. Scheduled to be converted to soft put bonds.
  2. Underwriting team identified as Goldman Sachs book runner, and Loop Capital Markets, Morgan Stanley and Depfa as co-Senior managers.
- CUS Series 2004C-2C, 2D and a portion of 2E (\$249 million):
  1. Hedged Bonds
  2. Scheduled to be refunded into VRDB Bonds and is expected to close in early May.
  3. Underwriter and Remarketing Agent will be Bank of America.
- CUS Taxable Series 2004C-3, C-4 and C-5 (\$200.4 million):
  1. Scheduled to be refunded to VRDB Bonds; switch from taxable puts
  2. Underwriter and Remarketing Agent is Merrill Lynch.

### **Houston Airport System**

As described above, the HAS has approximately \$345 million in ARS securities. However, unlike the CUS, the formula for the failed rate is less punitive although still relatively high. Additionally, in the interest of transactional efficiency, the HAS ARS restructure is being combined with other debt issues and identified refundings that have been delayed as a result of the credit market turmoil.

An additional issue with the HAS is related to the surety policy on existing HAS debt. Two of the three existing monoline insurers that are current providers of the HAS surety policy have had their credit rating downgraded below the requirement to serve, therefore that issue must be addressed as well as the cost of replacing those monolines. In the current market, surety policies are expensive and cumbersome. The surety policies in place must be re-qualified only when the issuer (HAS) issues new debt; therefore avoiding new debt issuance at this time eliminates the need to address this issue and avoids that cost. However, the savings on the potential refundings, as well as the lower rate should the ARS be converted could mitigate much of that additional cost.

These issues are currently being reviewed and a recommendation will be forthcoming.

### **Convention and Entertainment**

C & E, as outlined above, has \$150 million ARS outstanding. Like the HAS, the formula for the failed rate is low, in this case sub 4%. The intention is to examine the available cost effective alternatives, if any, related to this issue, once these larger more pressing transactions have been completed.



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Correspondence

To: Budget and Fiscal Affairs Committee

From: Michelle Mitchell, Director  
Finance Department

A handwritten signature in dark ink, appearing to be "MM", is written over the name "Michelle Mitchell".

Date: February 29, 2008

Subject: Credit Market Overview

Given the recent events in the credit markets, this memo provides an update and overview of the credit markets and how recent events have impacted portions of the City debt. While the credit markets have experienced turmoil over the past year, this memo will focus on one segment (Auction Rate Securities) that has been especially volatile and how it affects the City. Refer to Exhibit 1 for a summary of the City's various Auction Rate Securities ("ARS"). Even though the City's financial performance (both General Fund and Enterprise Funds) has been improving over the past few years, current market conditions have created a challenge in the ARS segment, which has necessitated consideration of a number of corrective actions to be discussed later in this memo.

### **Background**

In the spring of 2007, the credit markets were roiled with the news of the Sub Prime Mortgage issue (more broadly referred to as Collateralized Debt Obligations or "CDO's"). These events resulted in the re-evaluation of securitized mortgages and CDO's in light of their changing credit worthiness. Higher interest rates and the reset mechanisms contained in many of these Sub Prime loans has led to higher interest rate resets for the mortgage holder and the prospect of higher than anticipated default rates on the underlying mortgages. Weak underwriting standards and credit concerns also became an issue. This caused a downward re-evaluation of the value of these widely held securities. Many leading financial institutions were forced to revalue these securities at a loss and subsequently forced to recapitalize their balance sheets to offset the losses as these securities were marked to market. Investment Banking firms faced capitalization issues as a direct result of the re-pricing of these Sub Prime Mortgages and CDO's. Banks and other financial institutions face similar challenges.

More recently, most monoline insurers (Exhibit 2) have been negatively impacted. The drop in value of Sub Prime Mortgages and CDO's, which are backed in part by some of these monoline insurers, has resulted in downward ratings pressure on these insurers, as the failure of these securities might require the monoline insurers to cover these potential losses and increase reserves now to cover such anticipated claims.

Issuers like the City of Houston have used these monoline insurers to enhance the rating on long-term bonds, in addition to supporting other securities such as ARS. These problems with the monoline insurers translate into uncertainty, a lack of liquidity, and higher costs. This has made it more difficult for issuers, like the City of Houston, to benefit from, and remain with, certain financial products.

### **City Debt Profile**

The City utilizes a variety of debt structures and maturities as noted below:

- Short Term Debt such as TRANS and Commercial Paper Facilities
- Long Term Bonds
  1. Fixed Rate
  2. Variable Rate Demand Bonds (VRDB's)
  3. Auction Rate Securities (ARS)

The vast majority of the City's debt is issued at fixed rates, which means once the rate is set, it does not change, which could be 20 to 30 years. There has been no impact to the City's existing fixed rate debt. While the above segments are performing reasonably well, ARS are not. Given the rate differential illustrated in Exhibit 3, the City is pursuing alternatives to ARS, which are discussed in greater detail below.

### **ARS Background**

The ARS structure was first introduced in 1984 and involves securities whose rate of interest is reset periodically and that have long-term maturities. The interest rate is reset through a Dutch Auction process usually at intervals of 7, 28 or 35 days. They trade at par and are callable at par on any interest payment date at the option of the issuer. Although ARS are issued and rated as long term bonds, they are priced and traded as short term instruments because of the interest rate reset mechanism and the willingness, historically, on the part of the broker dealers to provide clearing bids so as to maintain an orderly market, ensure the success of each auction and provide liquidity to investors who may have wished to sell. The success of the ARS market, which now stands at about \$328 billion, can largely be attributed to the fact that investors were attracted by the incremental yields offered by these instruments which had come to be viewed as money market obligations.

Over the last few years the number and profile of investors in ARS have been undergoing some change, shifting to retail and high net worth investors. This development accelerated in light of the market turmoil that began last summer when volatility, illiquidity and "spread-widening" impacted the money markets, contributing to supply-demand imbalances in the ARS market. At that time, the market recorded its first spike in the number of failed auctions (not enough bids to buy the ARS). Whereas only 13 failed auctions, largely linked to credit events, were recorded during the entire period between 1984 and 2006, 31 failed auctions were believed to have occurred during the third and fourth quarters of last year. As investor sentiment turned more cautious, additional auction failures were being reported and a total of 32 failed auctions were reported during the two-week period starting at the end of January. More recently, failed auctions have

become widespread and common. The rise in auction failures follows from the banks' decreased willingness to provide market liquidity support, as they have no obligation to do so.

#### **Features: ARS vs. VRDB**

<b>Feature</b>	<b>ARS</b>	<b>VRDB</b>
Long Term Maturity	Yes	Yes
Interest Rate Reset	7, 28 or 35 days	7, 28 or 35 days
Short Rate/Long Rate	Short	Short
Puttable by bond investor	No	Yes
Liquidity Provider	No	Yes

The crucial issue that is highlighted above between the ARS and the VRDB's is the ability of the holder of the security to "put" their bonds. A holder of an ARS must hold their bonds until maturity unless a buyer can be found, while a holder of a VRDB has the option to put their bonds on any auction day.

#### **Alternatives**

##### **1. Status Quo**

If the City chooses to maintain the status quo the rate on the ARS securities will likely remain high and interest expenses will significantly exceed budgets.

##### **2. Convert or Refund to VRDB**

If the City chooses to either refund or convert to VRDB's, the interest rate paid by the City on this debt should return to normal levels as evidenced by Exhibit 3. In situations where the City has hedged debt (swaps), the preference will be to use VRDB's. The monoline insurer will need to be terminated on the current ARS and replaced by higher rated banks with letters of credit (LOC).

##### **3. Convert or Refund to "Puts"**

In some instances, the better option would be to convert or refund the current ARS securities to "puts." By converting to a put structure, the City could effectively lock in a fixed rate for a predetermined number of years (likely 2 to 5 years). This enables the City to lock in a rate for an intermediate period of time and get out of the current short-term resets. As the put date approaches, the City can review the options at that time, with the expectation that the markets will have stabilized. A benefit of this option is the ability to keep the insurer in place, and provide additional time for the insurer to stabilize as well.

#### 4. Fix Out

The City could also choose to “fix out” the debt. Under this option, the City would refund the current Auction Rate debt to long-term debt with fixed rates. A benefit of this option is the debt will be set at a fixed rate and will remove interest rate uncertainty. The downside is that interest rates may be higher than the VRDB option, but lower than the ARS. Additionally, fixed rates could likely be higher than normal because the cost of insurance by the few remaining, active monoline insurers has increased dramatically and because of the current uncertain market conditions. The debt could also be issued uninsured, if that is more economically beneficial to the City. Finally, a number of other entities (cities, counties, hospital districts, etc.) are in the same situation as the City. Consequently, the long-term market could soon be saturated with a number of new issues, which could push rates higher.

#### **Recommendation**

The City must address these issues and uncertainty in the ARS segment. The status quo option is unacceptable in most instances because the prospect of the ARS market correcting itself in the near term is unrealistic. The difficulty with the monoline insurers further compounds the problem. Each situation will be evaluated and recommendations will be made that are unique to the facts and issues pertaining to the specific debt.

Over the next few weeks, a number of RCA's will be forthcoming specifying a recommended solution for each individual situation.

# EXHIBIT 1

## City of Houston Short Term Portfolio

### City of Houston Combined Utility System

#### INDEX

1 Mo Libor 3.12000% 2/25/08

CUSIP	Maturity	Series	Type	Lead Underwriter	Issue Size (000s)	Outstanding (000s)	Insurer	Underlying Rating Moody's/S&P/Fitch	Index	Failed Auction Multiple <sup>4</sup>	Index Rate	Failed Rate <sup>4</sup>	Maximum Rate	Current Rating of Insurer as of 2/25/08
<b>Series 2004B - Tax-Exempt Auction Rate Securities</b>														
442435BH5	5/15/2034	B-1	ARS	Bear Stearns	\$75,000	\$75,000	XLCA	A2/A+/A	1 Mo Libor	250%	3.12000%	7.8000%	10%	A3/A-/A
442435BJ1	5/16/2034	B-2	ARS	Bear Stearns	\$75,000	\$75,000	XLCA	A2/A+/A	1 Mo Libor	250%	3.12000%	7.8000%	10%	
442435BK8	5/17/2034	B-3	ARS	Bear Stearns	\$67,775	\$67,775	XLCA	A2/A+/A	1 Mo Libor	250%	3.12000%	7.8000%	10%	
					<b>Total</b>	<b>\$217,775</b>								
442435CC5	5/18/2034	B-4	ARS	Goldman Sachs	\$75,000	\$75,000	XLCA	A2/A+/A	1 Mo Libor	250%	3.12000%	7.8000%	10%	A3/A-/A
442435CD3	5/19/2034	B-5	ARS	Goldman Sachs	\$75,000	\$75,000	XLCA	A2/A+/A	1 Mo Libor	250%	3.12000%	7.8000%	10%	
442435CE1	5/20/2034	B-6	ARS	Goldman Sachs	\$67,775	\$67,775	XLCA	A2/A+/A	1 Mo Libor	250%	3.12000%	7.8000%	10%	
					<b>Total</b>	<b>\$217,775</b>								
442435BZ5	5/21/2034	B-7	ARS	UBS	\$75,000	\$75,000	XLCA	A2/A+/A	1 Mo Libor	250%	3.12000%	7.8000%	10%	A3/A-/A
442435CA9	5/22/2034	B-8	ARS	UBS	\$75,000	\$75,000	XLCA	A2/A+/A	1 Mo Libor	250%	3.12000%	7.8000%	10%	
442435CB7	5/23/2034	B-9	ARS	UBS	\$67,775	\$67,775	XLCA	A2/A+/A	1 Mo Libor	250%	3.12000%	7.8000%	10%	
					<b>Total</b>	<b>\$217,775</b>								
					<b>Overall Total</b>	<b>\$653,325</b>								
<b>Series 2004C - Tax-Exempt Auction Rate Securities</b>														
442435BQ5	5/19/2034	C-1	ARS	JPMorgan	\$25,050	\$25,050	AMBAC	A2/A+/A	1 Mo Libor	200%	3.12000%	6.2400%	10%	Aaa/AAA/AA
442435BR3	5/20/2034	C-2A	ARS	JPMorgan	\$100,000	\$100,000	AMBAC	A2/A+/A	1 Mo Libor	200%	3.12000%	6.2400%	10%	
442435BS1	5/21/2034	C-2B	ARS	JPMorgan	\$100,000	\$100,000	AMBAC	A2/A+/A	1 Mo Libor	200%	3.12000%	6.2400%	10%	
442435BT9	5/22/2034	C-2C	ARS	JPMorgan	\$100,000	\$100,000	AMBAC	A2/A+/A	1 Mo Libor	200%	3.12000%	6.2400%	10%	
442435BV4	5/23/2034	C-2D	ARS	Lehman	\$100,000	\$100,000	AMBAC	A2/A+/A	1 Mo Libor	200%	3.12000%	6.2400%	10%	Aaa/AAA/AA
442435BW2	5/24/2034	C-2E	ARS	Lehman	\$98,150	\$98,150	AMBAC	A2/A+/A	1 Mo Libor	200%	3.12000%	6.2400%	10%	
					<b>JP Total</b>	<b>\$325,050</b>								
					<b>Lehman Total</b>	<b>\$198,150</b>								
					<b>Overall Total</b>	<b>\$523,200</b>								
<b>Series 2004C - Taxable Auction Rate Securities</b>														
442435BX0	5/25/2034	C-3	ARS	Lehman	\$23,100	\$23,100	AMBAC	A2/A+/A	1 Mo Libor	235%	3.12000%	7.3320%	10%	Aaa/AAA/AA
442435BU6	5/26/2034	C-4	ARS	JPMorgan	\$48,425	\$48,425	AMBAC	A2/A+/A	1 Mo Libor	235%	3.12000%	7.3320%	10%	
442435BY8	5/27/2034	C-5	ARS	Lehman	\$128,900	\$128,900	AMBAC	A2/A+/A	1 Mo Libor	235%	3.12000%	7.3320%	10%	
					<b>JP Total</b>	<b>\$48,425</b>								
					<b>Lehman Total</b>	<b>\$152,000</b>								
					<b>Overall Total</b>	<b>\$200,425</b>								

\* On June 10, 2004 the 2004B were swapped as follows: Goldman Sachs \$353,325 million, Bear Stearns \$150 million and UBS AG \$150 million.

\*\* On November 1, 2005 the 2004C were swapped in the amount of \$249.1 million on a floating to fixed basis with Royal Bank of Canada.

\*\* On August 31, 2006, the 2004C were swapped with a Constant Maturity Swap with Goldman Sachs Capital Markets in the amount of \$249.1 million

# EXHIBIT 1

## City of Houston Convention Center and Entertainment

CUSIP	Maturity	Series	Type	Lead	Underwriter	Issue Size (000s)	Outstanding (000s)	Insurer	Underlying Rating Moody's/S&P/ Fitch	Index	Failed Auction Rate Multiple <sup>4</sup>	Index Rate	Failed Rate <sup>4</sup>	Maximum Rate	Current Rating of Insurer as of 2/25/08
<b>Series 2001C - Revenue Adjustable Rate Bonds (Convention Center)</b>															
44237NDA7	6/30/2034	2001C	ARS	UBS	UBS	\$75,000	\$75,000	AMBAC	A3 / A- / NR	Footnote 1	175% <sup>3</sup>	1.950000%	3.4125%	10%	Aaa/AAA/AA
<b>Series 2001C - Revenue Adjustable Rate Bonds (Hotel)</b>															
44237NDB5	6/30/2034	2001C-2	ARS	UBS	UBS	\$75,000	\$75,000	AMBAC	A3 / A- / NR	Footnote 1	175% <sup>3</sup>	1.950000%	3.4125%	10%	Aaa/AAA/AA
						UBS Total	\$150,000								

## City of Houston Airport

CUSIP	Maturity	Series	Type	Lead Underwriter	Issue Size (000s)	Outstanding (000s)	Insurer	Underlying Rating Moody's/S&P/ Fitch	Index	Failed Auction Rate Multiple <sup>4</sup>	Index Rate	Failed Rate <sup>4</sup>	Maximum Rate	Current Rating of Insurer as of 2/25/08	
Series 2000P - Auction Rate															
442348L22	7/1/2030	2000P-1	ARS	Goldman Sachs	\$50,000	\$47,450	FSA	A1 / A+ / AAA	Footnote 2	125%	3.00000%	3.7500%	15%	Aaa/AAA/AA	
442348L48	7/1/2030	2001P-2	ARS	Goldman Sachs	\$50,000	\$47,225	FSA	A1 / A+ / AAA	Footnote 2	125% +10bp	3.00000%	3.8500%	15%	Aaa/AAA/AA	
Series 2002 - Auction Rate					Sub-Total	\$94,675									
442348V96	7/1/2032	C	ARS	JPMorgan	\$100,000	\$100,000	XLCA	A1 / A+ / A+	1 Mo Libor	200%	3.12000%	6.2400%	10%	<div>⬆️ </div>	

<sup>1</sup> Kenny or after tax equivalent rate, which is the product of AA Financial CP Rate and (1-Statutory Corporate Tax Rate)

<sup>2</sup> 7-day AA Composite CP Rate

<sup>3</sup> Maximum Rate is 175% of higher index

<sup>4</sup> Auction Failed Rates are contingent on underlying rating of issuer. These percentages reflect rates at current rating

Insurance Exposure		
Insurer	Outstanding	% Total
FSA	\$187,575	9.55%
XLCA	\$903,325	45.98%
AMBAC	\$873,625	44.47%
MBIA		
FGIC		
CIFG		
	\$1,964,525	100.00%



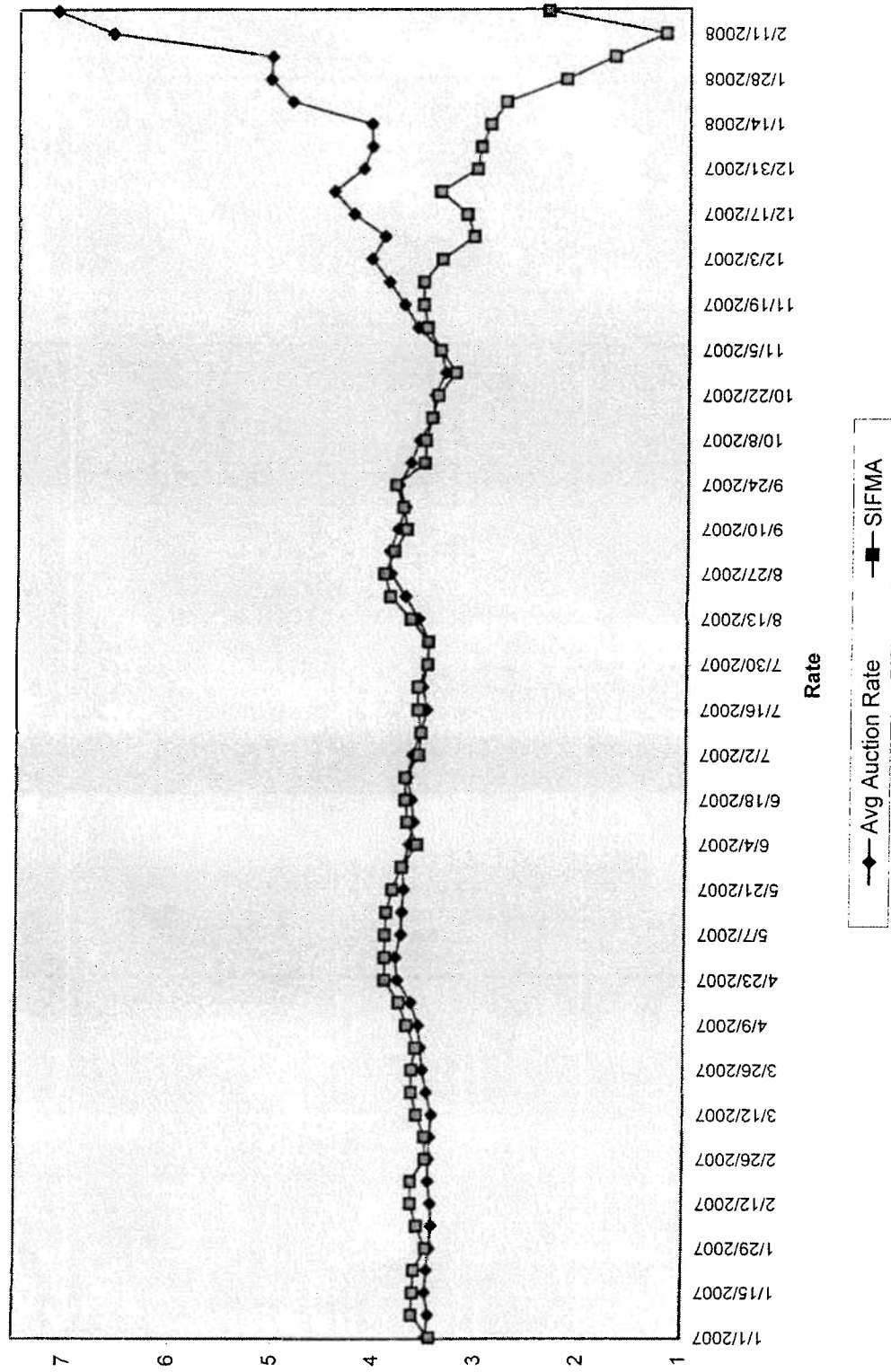
## EXHIBIT 2

## Bond Insurers Ratings Summary

	Moody's	S&P	Fitch
Ambac	Aaa	AAA	AA
	Review for Downgrade 1/17/2008	Creditwatch: Negative Implications 2/25/2008	Rating Watch Negative 1/18/2008
Assured Guaranty	Aaa	AAA	AAA
	Stable Outlook 12/14/2007	Stable Outlook 2/25/2008	Stable Outlook 12/12/2007
CIFG	Aaa	AAA	AAA
	Negative Outlook 12/14/2007	Negative Outlook 2/25/2008	Rating Watch Negative 2/5/2008
FGIC	A3	A	AA
	Review for Downgrade 2/14/2008	Creditwatch: Developing Implications 2/25/2008	Rating Watch Negative 1/30/2008
MBIA	Aaa	AAA	AAA
	Review for Downgrade 1/17/2008	Negative Outlook 2/25/2008	Review for Downgrade 2/5/2008
Security Capital Assurance (XL)	A3	A-	A
	Negative Outlook 2/7/2008	Creditwatch: Negative Implications 2/25/2008	Rating Watch Negative 1/24/2008
FSA	Aaa	AAA	AAA
	Stable 12/14/2007	Stable 2/25/2008	Stable 12/17/2007

**EXHIBIT 3**

**Houston Combined Utility Average Tax-Exempt Auction Rate Vs SIFMA Index**



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## Post-Pricing Report

### **\$653,325,000 City of Houston Combined Utility System First Lien Revenue Refunding Bonds, Series 2004B (Conversion)**

The \$653,325,000 Series 2004B Auction Rate Bonds ("the Bonds") were converted to weekly variable rate modes in five sub-series. The par amounts and initial interest rates follow. The City received very favorable initial pricing and experienced strong demand for the Bonds from all of the major money market funds and from middle market corporates which had been out of the market for a while.

All of the initial rates were set on various days of the week all to be reset on the following Wednesday, and each Wednesday thereafter; therefore, some of the rates reflect a shorter period than one week. Since the Bonds priced over the period of a week with three different underwriters, the statement of market conditions and results will be discussed separately for each pricing.

Some detailed marketing information provided by Debi Jones at Morgan Keegan and Karin Werness at Estrada Hinojosa (your Co-Financial Advisors) and the respective short-term underwriters for the variable rate bonds.

**\$225,000,000**

**Series 2004B-1**

**Bank of America Securities LLC**

This series (formerly B1, B4, B7) priced on Monday, April 7<sup>th</sup> and closed Tuesday, April 8<sup>th</sup>.

The City had an initial pricing call at 11:30 am Houston time, with an order period running from noon to 1:00 pm.

Bank of America recommended going out at a 1.70% level. Bank of America appropriately wanted a wide distribution of orders, with at least seven or eight purchasers in the initial sale so that there would be sufficient diversification of buyers going forward supporting the deal in subsequent weekly resets.

The demand for the Bonds was tempered due to the several, but not joint nature of the Letter-of-Credit ("LOC"). Purchasers of the Bonds will have to qualify all four banks through their credit committees, which may knock out some potential investors.

None-the-less, Bank of America felt that there would be strong demand for the issue.

In terms of rate context, SIFMA was at 1.89% the prior week and Bank of America high grade weekly levels were at 1.80%. SIFMA is reset every Wednesday, and therefore the initial rate set on Tuesday should be compared to the existing SIFMA of 1.89%. With one month LIBOR at 2.72%, a rate of 1.70% on the bonds would be approximately 62% of LIBOR which is a very favorable ratio for the City.

Despite the tax deadline impact, where taxpayers withdraw cash from their money market funds to pay taxes by April 15<sup>th</sup>, the Bonds were two times oversubscribed and Bank of America repriced to 1.60%.

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There were initially eight buyers at 1.70%, and with the repricing and allowing other buyers to join the purchasers at 1.60%, there were eleven buyers. This bodes well for future weekly rate-sets.

Rates reset Wednesday, April 16<sup>th</sup> to 2.00% with SIFMA at 2.10%

**\$210,550,000**

**Series 2004B-2 and 2004B-3**

**UBS Securities LLC**

These series (formerly B3, B8, and B9) priced on Wednesday, April 9<sup>th</sup>, after an initial pricing call at 8:45 Houston time. Series 2004B-2 closed on Thursday, April 10<sup>th</sup> and Series 2004B-3 closed on Friday, April 11<sup>th</sup>.

According to the underwriter at UBS, there was an abundance of cash in the market, despite the income tax impact. On Wednesday, money market funds were flush with cash with over \$504 billion in hand. Checks for withdrawals of cash for paying income taxes had not yet gone out. The large cash holdings reflected a flight to credit in these uncertain times.

The direct pay letter-of-credit vs. a standby letter-of-credit was an asset for this transaction. In a direct pay letter-of-credit, the LOC banks pay interest and principal directly when due, and the City reimburses them. Therefore, purchasers can look directly to the rated banks for their payment and do not need to rely on the underlying credit of the System. In addition, the UBS sales force had done significant pre-marketing.

High grade paper was trading at 1.76% and SIFMA had reset to 1.80%.

UBS recommended going out at 1.55%, an aggressive rate, for an hour long order period from 10:15 am NY time to 11:15. The issue was initially eight times over-subscribed with all the major money market funds participating, as well as middle market corporates (corporate cash management funds) which had been out of the market for a while.

UBS repriced to 1.50% and maintained a diversified purchaser base. Rates reset on Wednesday April 16<sup>th</sup> at 1.90% vs. 2.10% SIFMA index.

**\$217,775,000**

**Series 2004B-4 and B-5,**

**Goldman, Sachs & Co.**

These series (formerly B2, B5 and B6) were priced together on Thursday, April 10<sup>th</sup>, with Series 2004B-4 closing on Friday, April 11<sup>th</sup> and Series 2004B-5 closing Monday, April 14<sup>th</sup>.

After a brief pricing call, there was an hour order period from 1:00 to 2:00 pm. Goldman went out at 1.60%, which is 59% of one month LIBOR. SIFMA was at 1.80%.

Considerations at the time included the large sums of money accumulating in the money market funds with the flight to quality and safety in these turbulent times, a focus on creating and preserving a broad

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investor base for future weekly resets, and achieving the most favorable rates for the City. Since the issues were money market eligible, those funds were targeted.

There was some concern about the several, not joint nature of the letter-of-credit. With the strong market, that was not a problem, but going forward could be a factor in future remarketings, because purchasers need to qualify all four letter-of-credit banks in their commitment committees prior to purchase.

Goldman had orders from six money market funds, two orders for 100% of the deal. Total orders were \$577 million, which is just over two times subscribed. While Bank of America was able to lower the interest rate and still maintain all the buyers on Monday, by Thursday considerable cash was being drained from the money market funds to pay income taxes and corporate taxes. Goldman did not feel they could maintain a diversified investor base if they lowered the yield.

Due to the weakening market, with cash flowing out of the money markets to pay taxes, Goldman recommended staying at the 1.60% level and preserving a broader investor base. On Wednesday, April 16<sup>th</sup> the bonds reset to 2.00% while SIFMA reset on April 16<sup>th</sup> at 2.10%

Overall the City achieved excellent initial rates relative to the SIFMA index and the municipal short-term market in general. The bond structure and the System's underlying credit were well received in the market place. Most importantly, the City has extricated itself from the high rates and non-existent market for Auction Rate Securities.

Series	Par Amount (Millions)	Initial Interest Rate	SIFMA	Diff.	Closing Date	Remarketing Agent
2004B-1	\$225,000,000	1.60%	1.89%	-29bps	4/08/08	Bank of America Sec. LLC
2004B-2	\$135,550,000	1.50%	1.89%*	-39bps	4/10/08	UBS Securities LLC
2004B-3	\$75,000,000	1.50%	1.89%*	-39bps	4/11/08	UBS Securities LLC
2004B-4	\$75,000,000	1.60%	1.80%	-20bps	4/11/08	Goldman, Sachs & Co.
2004B-5	\$142,775,000	1.60%	1.80%	-20bps	4/14/08	Goldman, Sachs & Co.

\*Note: Bonds priced the morning of Wednesday, April 9<sup>th</sup>. SIFMA was reset to 1.80% at 4 P.M. EST.

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